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No. 87-1368

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

TRASATLANTIC FINANCIAL CO., S.A., NAYARIT INVESTMENTS, S.A., and FINVEST UNDERWRITERS AND DEALERS CORP.,

Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONERS

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ARGUMENT

I.

Respondent contends that this Court should not entertain the petition because the court of appeals erred in failing to dismiss petitioners' appeal on the ground that the three petitioning corporations were the "alter egos" of Tome, a fugitive co-defendant (Br. 16, n. 13). This contention is not properly before this Court. "The established doctrine . . . is that a party must cross-appeal or cross-petition if [it] seeks to change the judgment below or

any part thereof." Stern, Gressman, Shapiro, *Supreme Court Practice* (6th Ed.) 382 §6.35, and cases cited there. Accord, *Mills v. Electric Auto Lite Co.*, 396 U.S. 375, 381 n.4 (1970).[1]

II.

Respondent contends that petitioners did not challenge the misappropriation theory in the court of appeals and that, accordingly, the claim is not properly presented for review by this Court. However, petitioners clearly indicated to the court of appeals that the judgment of the district court could be upheld only if they were found to have violated the federal securities laws (Br. 21).

In any event, the court of appeals *sua sponte* raised the question and passed on it by squarely basing its decision on the misappropriation theory (A-21). The district court based its decision on the same ground and devoted a substantial portion of its opinion to justify the misappropriation theory (A-59-65).

Even if the lower courts had not expressly passed on the issue, it is crucial to the proper disposition of the issues which are undoubtedly properly before this Court. In such cases this Court may assume a disposition unfavorable to the party who failed to raise it. *United States v. Nobles*, 422 U.S. 225, 229 n.4 (1975). It seems inappropriate to argue that the court of appeals was deprived of the opportunity to overrule its three prior decisions applying the misappropriation theory.

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[1] Were the question properly presented, it could easily be demonstrated that the court of appeals was correct in three times (by two different panels) rejecting this contention. Whatever the court of appeals may have said concerning the admissibility of evidence, the record and the facts as found by the district court clearly establish that petitioners' identities were distinct from each other and distinct from that of Tome. Petitioners' only link to the questioned transactions was that Tome acted for each as agent and portfolio manager. Therefore, on general agency principles, Tome's misconduct could be imputed to them. The district court scrupulously respected their separate identities. Their respective liabilities were not determined to be co-extensive with those of Tome, but each was held accountable only for its separate profits on the allegedly illicit transactions.

III.

Respondent argues that this case does not involve the same issue which equally divided this Court in *Carpenter v. United States*, 108 S.Ct. 316 (1987).

The precise question which divided this Court was whether "criminal liability could [ ] be imposed on petitioners under Rule 10b-5 because 'the newspaper is the only alleged victim of fraud and has no interest in the securities traded.' " (108 S.Ct. at 320). Just as in *Carpenter*, Seagram, the victim, was neither a buyer or seller of the stocks traded by petitioners. Respondent's attempt to distinguish *Carpenter* was not perceived by the district court, which relied primarily on the circuit court decision in *Carpenter* as justification for its ruling that the misappropriation theory is alive and well.

The misappropriation theory runs afoul of the express wording of §10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b), which limits the power of the SEC to passing regulations "necessary or appropriate in the public interest or for the protection of investors." "Investors" in this connection can only mean persons who buy securities or sell those in which they had invested.

It was crucial in *Carpenter* that the Journal was neither a buyer or seller of the stocks traded in. (108 S.Ct at 319). Just as the Journal, Seagram was not a buyer or seller of the stocks traded in or otherwise a market participant.

The contention that the law governing petitioners' misconduct was not uncertain is surely mistaken. Respondent, in obvious disregard of the firmly established rule, deduces certainty from this Court's denial of certiorari in two cases.

The certainty of the law in this respect evidently was not apparent to four justices of this Court, to commentators, and to the committee of distinguished members of the bar which sought to bring about certainty in this field by new legislation.

IV.

The application of the misappropriation theory to make wrongdoers disgorge their ill-gotten profits inevitably requires the untenable assumption that a court of equity has power to order disgorgement for other than "restitutional purposes." The respondent boldly asserts that this power exists in SEC enforcement proceedings.

The assertion is squarely in conflict with *Tull v. United States*, 107 S.Ct. 1831 (1987), with all other cases in this Court dealing with disgorgement, and with principles of equity jurisdiction that have remained unquestioned for centuries. At most there is a difference, but no *rational* distinction can be made, nor has one been suggested by respondent.

The inevitable consequences of ordering disgorgement for purposes other than restitution were that vast funds have been collected to be disbursed by the SEC and district judges to such causes as appeal to their whim or benevolent instincts.[2]

Without questioning the propriety of such dispositions of disgorged funds, the SEC, in its reply, attempts to add further elements of irrationality. First, in plain conflict with the teachings of *Chiarella v. United States*, 445 U.S. 222, and *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2nd Cir. 1983), *cert. denied sub nom., Moss v. Newman*, 465 U.S. 1025 (1984), respondent suggests that persons who traded with petitioners have a cause of action for damages against them. Even respondent candidly admits that to recognize such a cause of action would require that at least *Moss* (and doubtless *Chiarella* as well) be overruled.

Respondent does not argue that the persons who traded with petitioners have a claim against the disgorged funds. Such a suggestion would contradict all proposals for distribution of such funds which the SEC has made in the past.

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[2] At an earlier stage of this case, the SEC suggested that the proceeds of disgorgement here should be paid to some investors protective organization.

Respondent also suggests that the true victim of the fraud, the tendering offeror, may have a claim for damages under the federal securities laws. This suggestion is far-fetched and obscures the very basis of the misappropriation theory. The predicate fraud of the misappropriation theory is that a person in a confidential or fiduciary relationship who misuses confidential information for his own benefit must account to his principal for any profits derived therefrom. *Carpenter*, 108 S.Ct. at 321. There is no doubt that the defrauded principal has a cause of action against the perpetrator of the fraud. In *Carpenter* the Solicitor General argued (Supplemental Br. p.7) that the Journal, the victim, was entitled to the profits its faithless employee obtained through the misappropriation of information. Doubtless, Seagram, the only victim, has a valid cause of action against petitioners, but that cause of action is in no sense dependent upon a violation of the securities laws nor restricted to such violations. It is a claim under state law and must be asserted as such.

If the logic of respondent is to prevail, the ill-gotten gains must be repaid twice; once to the victim, and once more at the behest of the SEC for the benefit of the objects of its bounty. It surely is irrational to contend that both the victim and the SEC are entitled to recoup the same ill-gotten gains.

CONCLUSION

For the foregoing additional reasons and those contained in the original petition herein, it is respectfully prayed that the Court issue the writ of certiorari as requested in the petition.

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Respectfully submitted,

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